SELECTOR® Money Management
2006 Second Quarter Review

After a very strong first quarter, equity markets experienced their first correction of the year in the second quarter of 2006. The S&P 500 declined by –1.44% in the second quarter, ending up +2.71% YTD. The NASDAQ Composite fell –7.17% in the second quarter, closing –1.51% YTD. The Russell 2000 index, after a very strong first quarter, had a –5.03% second quarter, finishing the first half +8.21%. International equities, which had also enjoyed a very strong first quarter, were lower in the second quarter with the MSCE EAFE Index –.1% and the MSCI Emerging Markets Index –3.8%. These two international indexes finished the first half of 2006 up +10.2% and +7.2%, respectively.

Like the aftermath of a summer thunderstorm, the final numbers for the quarter fail to reflect the high volatility experienced as the storm passed. Equity markets experienced a very strong recovery rally the very end of June following the Federal Reserves hike in short term interest rate. Prior to that rally, markets endured two waves of selling. The first wave began on May 10th and had all the appearances of a very normal correction. The second wave began on June 5th and was significantly more intense. In the course of the second quarter correction, relative volatility for domestic equities increased by over 50% and volatility for international equities increased by over 100%.

The Federal Reserve continued to raise short-term rates during the second quarter with the most recent increase being the catalyst for the end-of-quarter rally. Although they raised the federal funds rate to 5.25%, the comments that accompanied this increase led markets to believe that the Fed was ready to draw an end to their two-year old rate-hiking campaign. That implication sparked the strong rally in equities. In the course of the correction, bonds had failed to provide much solace, primarily due to the Fed's ongoing rate increases. The Lehman Brothers Aggregate Bond Index fell –0.04% in the second quarter after rallying sharply with equities the end of the month, but still remain –0.72% YTD.

At second quarter's end, SELECTOR® allocations reflect the adjustments made during the first quarter, but portfolio changes are imminent. Our previously planned May portfolio adjustment was delayed by the correction, quite simply because we abhor selling into weakness. Market leadership coming out of this correction has mirrored the prior leadership so the upcoming portfolio adjustments will reflect positive relative strength. But the portfolio volatility we recently experienced was unacceptable. While we anticipate maintaining comparable equity-to-bond ratios, we will be working to better contain volatility as we continue to mine the prospects of our existing Bull Market. SELECTOR® Aggressive Growth and SELECTOR® Growth allocations are 100% invested in equities. SELECTOR® Conservative Growth portfolios are 80% equities/20% bonds. SELECTOR® Balanced Growth is 60% equities/40% bonds, and SELECTOR® Income & Growth is 40% equities/60% bonds.

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 Sources: Standard and Poor's, Morningstar, Bloomberg, Lipper Analytical, CBS.Marketwatch.

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